Written Statement of
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Before the
United States Senate Committee on Finance
Subcommittee on Fiscal Responsibility and Economic Growth
Hearing Examining Whether There is a Role for Tax Reform in
Comprehensive Deficit Reduction and U.S. Fiscal Policy

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Overview

Chairman Nelson, Ranking Member Crapo, and distinguished members of the Committee. The topic of today's hearing is one of the most important issues that Congress will tackle over the coming months. I appreciate the opportunity to share the views of the Business Roundtable on this very important topic.

Business Roundtable (BRT) is an association of chief executive officers of leading U.S. companies with over $6 trillion in annual revenues and more than 14 million employees. BRT member companies comprise nearly a third of the total value of the U.S. stock market and invest more than $150 billion annually in research and development -- nearly half of all private U.S. R&D spending. Our companies pay $163 billion in dividends to shareholders. BRT companies give nearly $9 billion a year in combined charitable contributions.

Deficit reduction is a national imperative. Except for World War II, the federal debt of this country has never been larger as a share of income than today -- and under many projections the United States is on an unsustainable path of continuing increases in debt burdens relative to our country's ability to service it. At the same time, the U.S. economy suffers from stagnating economic growth and insufficient job creation. Not since the Great Depression has the need for job creation been greater.

There are no easy solutions to these two issues, and some will argue that anything you do to improve one will only worsen the other. While not a magic bullet, strategies designed around <u>maximizing economic growth</u> do provide a win-win solution. Economic growth strategies create jobs, increase wages, and improve the standard of living of Americans. Economic growth also reduces the burden of any amount of outstanding debt relative to national income. Economic growth results in more revenue for the government and makes any given level of government spending more affordable as a share of national income.

The desire for economic growth is bipartisan. To improve economic growth, we need to reexamine a host of existing laws and regulations, and impose strict cost-benefit rules on new ones. This is true across the board, in every government agency and every sector of the economy.

My testimony today focuses on one such area -- the topic of your hearing -- the important role of tax policy toward business to promote economic growth and improve the ability of American workers to compete in the fast changing world economy. Corporate tax reform done right can grow the economy by enhancing the ability of every company operating in the United States, whether domestically headquartered or foreign, to better compete in the world economy.

There are no secrets as to the elements that U.S. corporate tax reform must encompass. The U.S. corporate tax system has failed to keep pace with the changing global economy. Today the U.S. corporate tax system is an outlier at a time when capital is more mobile and the world's economies are more interconnected than at any time in history. Our current tax system discourages U.S. companies from competing abroad and it discourages capital investment in the United States. It is quite possibly the least competitive tax system in the entire OECD. The end result of this tax system is a more slowly growing capital stock of both physical capital and intellectual property, reducing the productive capacity of the U.S. economy and resulting in fewer jobs and lower wages than under the tax systems of our trading partners.

Tax reform that makes our corporate tax system more competitive should follow the tax systems of our trading partners. American corporations should be taxed on their active business operations only on the income generated from their U.S. activities, as under the territorial tax systems of our trading partners. And the statutory rate of tax should be brought down substantially for all corporations. Many have talked about a 25 percent tax rate. Indeed, when combined, a 20 percent federal rate and 5 percent state rate would create a U.S. statutory tax rate equal to the average of our trading partners. These recommendations are largely those of the President's Fiscal Commission, chaired by former Senator Alan Simpson and Erskine Bowles, on which four members of this subcommittee served with distinction.

And like the recommendations of the President's Fiscal Commission, Business Roundtable believes that these reforms can be undertaken in a fiscally responsible manner, with the cost of these reforms to be offset as much as possible through aggressive base broadening in ways similar to the practices of our trading partners.

In evaluating the cost of adopting such reforms, it is important to measure revenue neutrality against the revenue stream that the government would otherwise have collected. In doing so, I urge you to consider that many provisions in the tax code, although they may have statutory expirations, have been routinely extended year after year. In the case of the R&D tax credit, it has been part of the tax code for the past 30 years, extended on 14 separate occasions. Provisions that have been repeatedly extended are realistically part of the baseline against which the revenue from a reformed tax system should be measured.

This simpler, flatter, lower rate tax system would boost long-term economic growth by attracting investment to the United States, increasing the growth of U.S. companies and their domestic employment, and making the United States an attractive location for multinational businesses.

Some will argue that instead of tax reform, business tax increases should be used for deficit reduction now, with tax reform to be delayed to another time. I strongly urge you to reject such a path. Corporate tax reform is essential to increase U.S. competitiveness, jobs, and economic growth. Not only will business tax increases set us in the exact opposite direction -- less competitive American businesses, fewer jobs, and reduced growth -- it will make the eventual task of tax reform even harder as any remaining base broadening will look far less attractive and the ability to make positive changes to the tax code all the more challenging. Comprehensive tax reform is a challenge, but it will not get easier by making piecemeal changes in the tax base to raise revenue in legislation that fails to address the fundamental reforms that can help achieve a higher U.S. standard of living.

A Troubled Economic Landscape

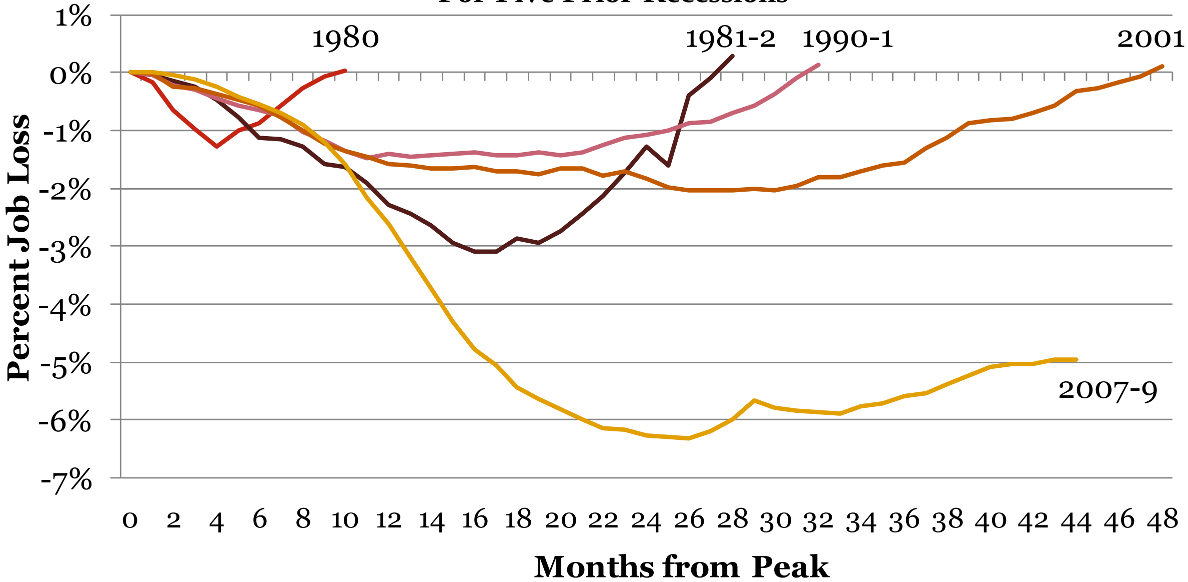
While the official scorekeepers declared the 2007 recession ended more than two years ago, the U.S. economy remains very weak, unemployment is unacceptably high, and the economic news of the past few months suggest these conditions are likely to persist without better economic policies.

The official unemployment rate is 9.1 percent with 14 million workers unemployed. Others note the rise in the large number of people who are omitted from these figures, either because they have stopped looking for work as they wait for better prospects or they are working part-time while desiring full-time employment. Using this broader concept of unemployment, more than 25 million Americans need a job -- or 1-in-6 of the American workforce.

With ongoing growth of the working age population exceeding the new jobs created each month, the "job gap" confronting us gets worse. Brookings economists calculate that it would take almost 12 and a half years -- not until 2024 -- to return employment to the same percentage of the working age population as before the recession under the optimistic assumption that we continuously add 208,000 jobs per month (representing average monthly job growth in the best year of the past 10 years) for the next 12 and a half years. Clearly, this is too long for the unemployed and those entering the labor force to wait. Yet some might argue, our current policies are insufficient to even generate employment gains this rapidly.

As Figure 1 on the next page shows, now 44 months since the start of the recession, payroll employment remains 5 percent below its 2007 level. This recession is far deeper and its effects far more lasting than any of the prior recessions we have faced in modern history.

Figure 1.--Percent Change in Payroll Employment from Peak Employment For Five Prior Recessions



Source: Bureau of Labor Statistics, U.S. Department of Labor, September 2011.

Employment follows economic growth. Over the past six months, gross domestic product has grown at less than one percent and over the past four quarters by only 1.5 percent. In contrast, following the deep 1981-1982 recession, GDP growth was 7.7 percent in the first year of the recovery and 5.6 percent in the second year.

According to the latest *Blue Chip* economic forecast, economic growth in 2012 is forecast at just 2.2 percent, after only 1.6 percent growth this year. We have a growth deficit where we are failing to grow sufficiently to add new jobs and bring down unemployment.

Tax policy must focus on growth. One doesn't have to be a supply-sider to understand that some taxes are more destructive to job creation and economic growth than other taxes. Economists generally agree that the corporate income tax is one of the most harmful taxes to job creation and wage growth. Tax reform that makes American companies more internationally competitive in foreign markets and that brings down the corporate rate to attract investment will grow the economy, providing the steady long-term growth that makes a real difference.

If sound corporate tax reform and other reforms to our laws and regulatory systems resulted in the economy growing just a half percentage point faster year after year, this economy would provide millions more jobs for Americans and faster growing wages for this generation and future generations of American workers. We can grow the economy and we must.

America's Companies and America's Workers Face a Hyper-Competitive World

As New York Times columnist Thomas Friedman wrote in his 2005 book of the same name: "the world is flat." American companies and American workers have never faced such strong competition from around the globe, both in competing for consumers in our domestic market and abroad.

Reductions in the cost of communication and transportation, falling trade and investment barriers, and increasing incomes of consumers around the world have opened the door to competition on a truly global scale. With 95 percent of the world's consumers outside the United States, competition for these markets is fierce for American companies.

Cross-border investment has become an increasingly important way in which modern business activities are conducted. U.S.-headquartered companies today account for less than one-fourth of all cross-border investment in the world, down from about 40 percent in the early 1980s.[1] In other words, cross-border investment of foreign-headquartered companies is now three times greater than that of U.S.-headquartered companies.

This intense competition means that American-headquartered companies are no longer the dominant companies in most foreign markets. Measured by total sales, just eight of the largest 20 companies in the world were American companies in 2011, down from 13 in 1985 and 17 in 1960. A decline in America's competitiveness in world markets results in fewer American jobs, lower wage growth, and a more slowly growing economy.

Research confirms that there is a significant connection between the success of American companies and the growth of jobs and wages of American workers. When American companies succeed in world markets, they also add jobs at home and expand the U.S. economy.

American-headquartered multinational companies support 63 million American jobs: they directly employ 22 million Americans in their U.S. operations and they support an additional 41 million jobs through their U.S. supply chains. In 2008 American multinationals purchased $1.52 trillion in supplies from American small businesses.

American multinational companies are responsible for significant growth of productivity in the United States. Higher worker productivity in turn is the key determinant of higher wages and a higher standard of living for American workers. A Federal Reserve Board study finds that American companies with international operations are responsible for more than three-fourths of the increase in labor productivity in the U.S. corporate sector between 1977 and 2000 and all of the labor productivity growth in the U.S. corporate sector in the late 1990s. Higher productivity results from greater use of advanced technology, organizational efficiency, and innovation spurred by R&D.

Further, according to analysis of the Bureau of Economic Analysis, this productivity advantage increases with the global scope of a company's operations. In 2008, American companies

[1] See Business Roundtable, *Taxation of American Companies in the Global Marketplace: A Primer* (April 2011) for complete sources and references to material in this section.

operating in 10 or more countries had 54 percent greater value added per employee than those companies operating in just one foreign country and 21 percent greater value added per employee than companies that operated in two to nine foreign countries.

America's businesses have the capability to expand into world markets and deliver the highest quality and most innovative products to consumers. But we are currently competing on a tilted playing field with an antiquated tax code developed for a different era. Tax reform can level the playing field and allow American businesses and their American workers to compete at home and abroad against the best foreign businesses in the world.

U.S. Corporate Tax Reform: Worldwide vs. Territorial Tax Systems

Current U.S. tax policy fails to recognize the value contributed to our economy by successful American companies with worldwide operations.

We would never think to tax a foreign-headquartered company on their earnings outside the United States, but our current law imposes tax on the worldwide income of U.S.-headquartered companies by virtue of their being incorporated in the United States. In effect, we treat U.S.-headquartered companies less favorably than foreign companies by this disparate tax treatment.

The trend over the past 15 years among OECD countries has increasingly been away from worldwide systems of this type toward "territorial" systems under which the country of incorporation exempts active foreign business income from domestic taxation. Today, 26 of the 34 OECD countries employ territorial tax systems, with Japan and the United Kingdom the most recent to adopt this system in 2009. Of the 26 territorial countries in the OECD, 18 fully exempt foreign earnings while eight exempt 95 percent to 97 percent of foreign earnings (see Table 1, next page).

Table 1.--OECD Home Country Method of Tax of Foreign-Source Dividends

Method of Taxation	Countries		Dividend Exemption Percentage
Territorial Tax Systems	**OECD Countries with Territorial Tax Systems**		
Exempt foreign-source dividends from domestic income taxation through territorial tax system[1]	Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, Hungary, Iceland, Luxembourg, Netherlands, New Zealand, Portugal, Slovak Republic, Spain, Sweden, Turkey, United Kingdom		100% exemption
	Norway		97% exemption
	Belgium, France, Germany, Italy, Japan, Slovenia, Switzerland		95% exemption
Worldwide Tax Systems	**OECD Countries with Worldwide Tax Systems**		
	Country	**2011 Tax Rate**[2]	
Worldwide system of income taxation with deferral and foreign tax credit	Chile	17.0%	0% exemption
	Greece	20.0%	0% exemption
	Ireland	12.5%	0% exemption
	Israel	24.0%	0% exemption
	Korea	24.2%	0% exemption
	Mexico	30.0%	0% exemption
	Poland	19.0%	0% exemption
	United States	**39.2%**	0% exemption

[1] In general, territorial tax treatment providing exemption of foreign-source dividends depends on qualifying criteria (e.g., minimum ownership level, minimum holding period the source country, income tax treaty status, and/or the source country tax rate).
[2] Refers to generally applicable tax rate, including surcharges, of combined central and sub-central government taxes.

The seven OECD countries other than the United States that employ worldwide tax systems have tax rates significantly below the United States (an average rate of 21 percent), and, excluding Ireland (which has a 12.5 percent tax rate), undertake little foreign investment (together accounting for less than 2 percent of the world's outward foreign direct investment).

A territorial tax system would allow American companies to compete on a level playing field in foreign markets. Under current law when a U.S.-headquartered company is competing abroad against a foreign-headquartered company, it must factor in the higher rate of tax it will pay on its foreign earnings when it brings these earnings home. This higher rate of tax makes the U.S.-headquartered company less competitive relative to its competition -- it can only successfully compete if it is sufficiently more productive to overcome this tax disadvantage and still earn a competitive rate of return on its investments.

The unfortunate outcome is that the United States is giving away markets to foreign-headquartered companies that may be less efficient than our American companies because American companies cannot overcome this extra tax hurdle imposed by our worldwide tax system. By reducing the market potential of our American companies, their U.S. operations are smaller than they would otherwise be, their U.S. employment is reduced, and their purchases from U.S. suppliers are reduced. Each of these factors results in a contraction of the U.S. economy and fewer jobs and lower wages for American workers.

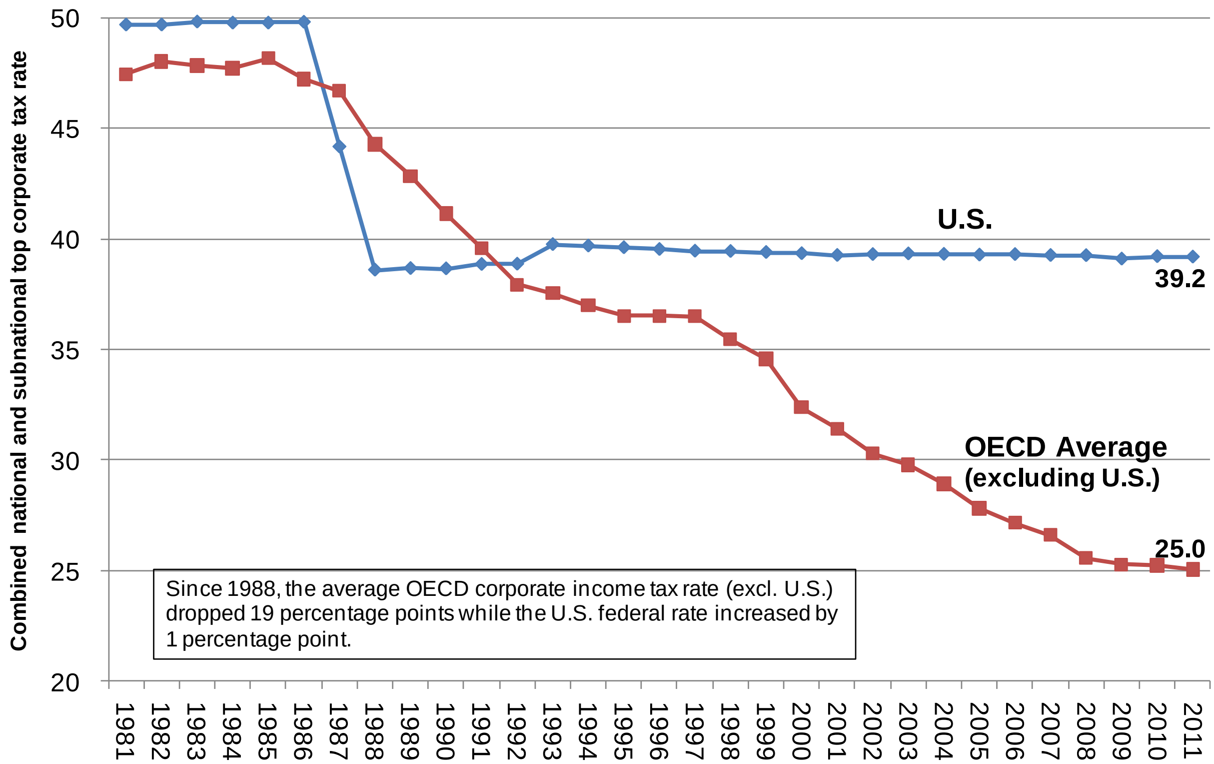
U.S. Corporate Tax Reform: Statutory Corporate Tax Rate

Another essential change to our tax system to promote economic growth is a significant reduction in the statutory corporate tax rate. The U.S. rate is out of step with our trading partners to the detriment of investment in the United States. The loss in investment and economic activity reduces economic growth and job creation.

According to the OECD, the U.S. statutory corporate tax rate (including deductible subnational taxes) was 39.2% in 2011, more than 50 percent higher than the 25.0 percent average tax rate for the rest of the OECD. The U.S. rate is the second highest among the 34 countries in the OECD, only fractionally below Japan's.

Since 1988, the average OECD corporate income tax rate (excluding the United States) has dropped 19 percentage points while the U.S. federal rate increased by one percentage point over the same period (see Figure 2, next page).

Figure 2.--Average OECD and U.S. Corporate Tax Rates, 1981-2011



Source: OECD Tax Database, 2011.
U.S. rate for 2011 is based on the 35-percent federal tax rate and average state taxes of 6.44 percent, which are deductible from federal taxes.

And reductions in the corporate rate continue as countries know this reform plays a significant role in attracting investment and boosting growth in their economies. For example:

- The United Kingdom reduced its rate in stages from 28% in 2010, to 26% in 2011, with announced budget plans to lower it to 25% in 2012 and 23% by 2014.

- Canada reduced its federal rate from 22% in 2007 to 18% in 2010, to 16.5% in 2011, and 15% in 2012. In 2012 the combined federal and provincial rate will be about 25%.

A substantially lower corporate tax rate would result in more investment in the United States by both domestic and foreign multinational companies.

An increase in capital investment translates into to an increase in jobs, wages, living standards and higher worker productivity.

Because of the effect of the corporate income tax on capital investment and wages, economic research suggests that a significant part of the corporate income tax is more appropriately viewed as a tax on labor through a reduction of employment opportunities and wages—and not primarily a tax on the owners of capital, including shareholders.

A study by the Congressional Budget Office, for example, estimates that 70 percent of the burden of the U.S. corporate income tax is borne by American workers in the form of lower wages, with the remaining 30 percent borne by Americans through a reduced rate of return on their savings.

Recent research by the OECD concludes that the corporate income tax has the most adverse impact of economic growth of any tax.

In a 2005 study, the Congressional Joint Committee on Taxation compared individual income tax reductions and corporate income tax reductions and concluded that a reduction in the corporate income tax had the greatest impact on increasing long-term economic growth, due to increased capital investment and increased labor productivity

Our competitors have reduced corporate tax rates as a way to attract investment, create jobs, and increase wages. We need to do the same, especially at this time of stagnating wages and insufficient job creation.

Proposals

The U.S. should adopt a competitive territorial tax system comparable to those of our trading partners and reduce the federal corporate tax rate to a level that when combined with state income tax burdens results in a combined statutory tax rate no higher than the average of our major trading partners.

Together these proposals would boost the worldwide competitiveness of American companies, increase jobs for American workers, increase wages, and promote long-term economic growth for the United States.

Conclusion

It is clear that our economy suffers from many deficits -- the fiscal deficit, a jobs deficit, and a growth deficit. Policies directed at improving the long-run growth of the economy can help us bring down all three of these deficits.

Corporate tax reform is one of the most straightforward policies this Congress can undertake to promote economic growth. A simpler, flatter, lower rate corporate tax system that incorporates a competitive territorial tax system like our trading partners can provide the foundation for a U.S. corporate tax system designed to promote economic growth and job creation.

These are not abstract ideas. Nearly every one of our trading partners has a corporate tax system that resembles this proposal. The design elements of this reform are very close to those put forward by the co-chairmen of the President's Fiscal Commission.

Growth enhancing tax reform is an important element of a comprehensive deficit reduction program, but its benefits are even greater. It should be fully pursued.

On behalf of Business Roundtable, I look forward to working closely with this Committee toward this important goal, reducing the deficit, increasing economic growth, and putting the economy on a path of sustained job creation.